

Central Intelligence Agency



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# DIRECTORATE OF INTELLIGENCE

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China's Anticorruption Campaign: A Threat to Reforms?

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## Summary

The much-publicized growth of corrupt activities among Chinese officials has forced reformist leaders to reassert central control over some types of spending and commodity distribution. Measures announced at the recent session of the National People's Congress (NPC) are intended to prevent speculation in scarce goods, payment of excessive bonuses, and unauthorized price hikes -- the so-called unhealthy practices China.

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We believe the reformists themselves initiated the anticorruption drive, but conservative critics have used the issue to attack the reform program. The reformists appear to retain the upper hand and have declared the problem to be "receding," but at the cost of having to criticize some of their own reform initiatives. We believe that although the reforms have not suffered a serious setback, the specter of corruption will probably slow further reforms in enterprise autonomy and in the marketing of scarce goods. The recently announced measures probably will curtail the most flagrant malfeasance, but cadre corruption will continue to be a problem for Beijing as

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[redacted]

long as the party's role in China's modernization remains so poorly defined. [redacted]

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### Unhealthy Practices

For the past four months, Chinese domestic press reporting and leadership statements have been dominated by calls to eliminate so-called "unhealthy practices" -- activities that include cases of individual corruption, bureaucratic malfeasance, and degenerate social practices. Unlike earlier crackdowns on crime, the drive to eliminate these practices is aimed at party members and government officials, including those at relatively high levels. [redacted]

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The unhealthy practices that have received the greatest attention have been those that fuel inflation: unauthorized price hikes, speculation in scarce goods by officials, and unjustified raises and bonuses. These activities, which for a period in early 1985 were collectively referred to as the "three new unhealthy practices," have remained the central targets throughout the campaign. [redacted]

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Other unhealthy practices cited during the campaign have included throwing lavish banquets, supplying free clothing and lunches to workers and staff, publishing and selling "unhealthy" tabloids, holding lotteries, giving unauthorized promotions, cadre extorting money from collective and individual enterprises, setting up new government organs or posts, smuggling and black market currency speculation, and falsifying statistics and reports. [redacted]

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Specific examples include:

- o A municipal party committee in northeastern China set up a trading company that made 440,000 yuan by reselling 10,000 tons of steel.
- o The Beijing Discipline Inspection Commission discovered over 160 public organizations engaged in trading scarce consumer goods, together making 131,000 yuan in illegal profits by reselling 6,900 color TVs and 85 cars in the last four months of 1984.
- o People's Daily reported that military units in Fujian had set up 19 trading companies in late 1984 in violation of central directives. The companies had already made over 3.6 million yuan, and had signed contracts worth an additional 8 million yuan when they were shut down early this year.

- o A newly established company in Guangdong spent 120,000 yuan on a lavish banquet to celebrate its opening. [redacted]

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### Origins of the Campaign

Concern over corruption has been a constant feature of China's political landscape. One of the objectives of the current party rectification drive, under way since late 1983, has been to repair such defects in cadre work style and party discipline. [REDACTED]

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Party leaders foresaw that loosening bureaucratic controls and expanding economic opportunities would create possibilities for cadre corruption and bureaucratic malfeasance. A number of specific measures were taken to control anticipated abuses. For example, last August, Central Document (CD) 27 was issued, prohibiting officials and government organizations from engaging in business activities unless authorized to do so. CD 27 was circulated at about the same time as CD 28 -- the draft of the economic reform document subsequently approved by the Central Committee at the October Plenum. [REDACTED]

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Hu Yaobang reportedly stated at the October Plenum that taking advantage of the reforms for personal gain was "an unhealthy practice ready to emerge." Beijing may not have anticipated the scale of abuses, however. Central concern grew as news reports of malfeasance proliferated and as statistics became available showing dramatic jumps in enterprise wages and bonuses and excessive growth in credit. [REDACTED]

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In response, party bureaucracies stepped up the drive against unhealthy practices. The Central Commission for Guiding Party Rectification (CCGPR) published a document in late November noting that previous efforts to prevent unhealthy practices were not enough and that new measures were needed. In December, The Central Discipline Inspection Commission (CDIC) published a circular directing discipline inspection units and party committees to focus on correcting unhealthy practices. The State Council issued a directive in late December, specifically prohibiting the "indiscriminate issuing of bonuses, allowances, or bonuses in kind." [REDACTED]

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Despite the stream of central documents and high-level meetings, lower-level units took a wait-and-see approach through the first months of 1985. Even Deng Xiaoping complained that officials were ignoring central guidelines on curbing unhealthy practices with the attitude that "upper levels have policies and lower levels have countermeasures." Beijing was forced to apply extraordinary pressure to get grass-roots units to obey directives. In late February, central authorities convened a meeting of provincial governors, ordering them to bring their provinces into line with central directives on controlling price hikes and unhealthy practices. At a joint CCGPR - CDIC work conference held from 28 February to 6 March, the elimination of "new unhealthy tendencies" and the strengthening of party discipline were declared to be the "prominent, important points" of the second stage of party rectification. Even those units that had completed rectification were warned that remedial work might be in store to deal with malfeasance. [REDACTED]

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### Closing the Loopholes

In his work report to the National People's Congress in late March, Premier Zhao Ziyang outlined a series of administrative measures intended to close loopholes and curb unhealthy practices:

- o Returning distribution of scarce consumer goods to central control by "direct advance sales," intended to eliminate speculation in these commodities.
- o Placing enterprise wage and bonus funds under bank oversight.
- o Increasing the supervision over issuing credit.

Additional measures instituted by central authorities to curb unhealthy practices include banning lotteries and tightening central control over buying and selling motor vehicles. [REDACTED]

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These measures appear to contradict some elements of the reform program, for example reestablishing bureaucratic oversight over enterprises and putting a damper on expanded use of the marketplace for commodity circulation. They demonstrate that in many cases Beijing will have to tighten control over economic activity and define its limits before decentralization can work effectively. [REDACTED]

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Beijing has also raised the specter of a crackdown on those who have committed economic crimes for personal gain. In a recent interview, Hu Yaobang indicated that as many as 10,000 may be liable for prosecution. As a recent Liaowang article noted, "The door of reform is wide open, but so is the jail door." [REDACTED]

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### Why Unhealthy Practices?

The economic reforms of Deng Xiaoping and his proteges created a potent mixture of incentives, opportunities, and regulatory gaps that led to the surge in unhealthy practices. Some factors predate the reforms, including shortages of both consumer goods and essential industrial materials. Others have emerged with the reforms. [REDACTED]

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In some cases, malfeasance grew out of ambiguities in the reform program. The rush of government bodies to set up trading companies in late 1984 was in part a response to central calls to enliven commodity circulation. Uncertainty over how factory managers should use material incentives contributed to the growth in bonuses and other rewards. An early February Renmin Ribao commentary

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admitted broadly that "so many new things have emerged in carrying out reform that it is not easy to distinguish right from wrong." [redacted]

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In our view, another major cause of unhealthy practices has been the erosion of party members' traditional prerogatives and authority under the reforms. Despite its insistence that party committees have important tasks in carrying out reforms, the national leadership has not fully defined a constructive role for local party units. In addition, cadres are concerned that their wages will not keep pace with inflation, at a time when other segments of Chinese society are being encouraged to "get rich first." As a result, many cadre have used their political connections to engage in speculation and other business activities, often under the guise of carrying out economic reforms. [redacted]

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Chinese leaders recently noted that the expectation that future enterprise wages and bonuses would be based on 1984 levels exacerbated the growth in wages and bonuses in late 1984. Although this is important, the growth in bonuses also reflects the egalitarian approach to distribution which remains engrained in the Chinese economic system. In most cases, managers have little incentive to resist worker expectation of equal treatment, regardless of individual or enterprise performance. On the contrary, the increasing role of worker preference in selecting management prompts factory directors to provide generous across-the-board bonuses. [redacted]

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The creation of Special Economic Zones and other economic regions has opened various loopholes, which officials in these areas have been quick to exploit. For example, to promote the development of Hainan, authorities removed the import duty on motor vehicles shipped to the island. Without proper oversight, officials used the exemption to import vehicles for resale to other parts of China. Authorities recently confiscated 3,000 vehicles in Wuhan that had been imported through Hainan and were being shipped to other points. [redacted]

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#### Conservatives vs Reformers?

We believe reformers initiated the campaign against unhealthy practices as part of their effort to control inflation, which they perceive is the greatest potential stumbling block to the reform program. Conservative elements in the party nonetheless have played a major role in the campaign's development. The heightened attention to the issue is in part due to the tension between conservative and reformist elements, as each camp has sought to establish its anticorruption credentials and maneuver the campaign to its advantage. [redacted]

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Conservatives appear to have gained some ground. The Central Discipline Inspection Commission, headed by Chen Yun, has increased its strength and visibility by establishing and pursuing campaign goals. Some conservatives, such as propaganda chief Deng Liqun, who have kept a low profile since the "spiritual pollution" campaign was cut off in early 1984, have become somewhat more active. We have also seen renewed sniping about "spiritual pollution" side effects of

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the reforms. The spread of unhealthy practices has forced regime spokesmen to admit that they over-emphasized the prospect that people could get rich quick through the new policies. [ ]

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Despite such gains, we believe conservatives thus far have not been able to use the campaign to their best advantage, and reformers have generally succeeded in preventing the campaign from being used to attack the reforms directly.

- o Reformists took the lead in the campaign and have avoided any suggestion of personal involvement with corrupt practices or willingness to tolerate such practices in others.
- o The reformers have skillfully managed the campaign thus far, allowing conservatives to voice their concerns without gaining the initiative.
- o Unhealthy practices could prove to be a double-edged sword in a reformist - conservative struggle. Because the perpetrators are party and government cadre, the spread of unhealthy practices has tarnished the image of the party and the government bureaucracy. Conservatives, some of whom may be guilty of unhealthy practices as well, probably wish to avoid calling attention to this fact.

Nonetheless, the potential for the campaign to be used to attack elements of the reform program still exists, and reformers clearly are anxious to stay ahead of the issue. [ ]

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#### What's Ahead?

Beijing is now, in effect, declaring victory, claiming that the high tide of unhealthy practice has ebbed. For example, at a late March press conference, Vice premier Yao Yilin stated that unhealthy practices were a "receding problem." In addition, leaders are vigorously defending the reform program, claiming that the reforms are in no way responsible for the surge in unhealthy practices. [ ]

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Hu Yaobang recently announced Beijing is pressing ahead with plans to retire elderly cadres and install reform supporters in key leadership slots. We believe the increased attention to the retirement of elderly cadres is in part an effort by reform leaders to avoid giving the impression that they have lost the initiative or that the reforms themselves have stumbled. [ ]

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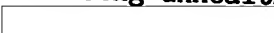
The degree to which reforms have been slowed by unhealthy practices appears to be minor. Nearly all elements of the reform program remain intact, the reformists still have the initiative, and we expect to see continuing movement in the crucial areas of price and wage reform in the months ahead. [ ]

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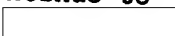
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Reformers can take little consolation from this, however. Although the recently announced administrative measures should put the cap on the most flagrant of the inflation-causing unhealthy practices, we believe the problem of corruption will persist. 

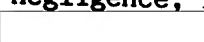
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The measures announced at the NPC address specific types of bureaucratic malfeasance, but other unhealthy practices remain unchecked. For example, the problem of extorting money or privileges from collective enterprises and specialized households -- often mentioned in local media -- will be hard to eradicate. Lacking programmatic measures to deal with such practices, Beijing probably will keep a muted anticorruption campaign alive and will continue to stress curbing of unhealthy practices in the rectification process. 

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We believe the problem of unhealthy practices will be an important limiting factor in reforms related to increased enterprise autonomy. The experiment to use capitalist management techniques within China's socialist system has stumbled because of the spread of malfeasance, demonstrating that additional preparatory work is needed before reforms can take hold in this area. The growth of corruption probably will also slow the pace of reforms in commodity distribution. The surge in speculation and profiteering has demonstrated the problem Beijing faces in lifting controls over scarce goods, particularly in the face of growing consumer demand. 

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The unhealthy practices episode appears to have reconfirmed reform leaders' belief that successful party rectification is the key to economic reform. We expect to see them continue their efforts to restructure the party from within, retiring elderly members and recruiting educated cadre who will be able to function as expert managers in the reformed economy. As long as the party's role in the reform program remains poorly defined, however, leaders must expect that lower-level cadre will continue to hinder reform efforts, either through negligence, lack of understanding, or intentional abuse of their prerogatives. 

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